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## Financial Products and Services Fact Sheet

The Progressive Consumption Tax (PCT) is meant to tax spending, not savings or earnings. To achieve this, the *Progressive Consumption Tax Act* (PCTA) contains special rules to ensure that savings and investment income, such as interest income, are not taxed.

Financial products and services are subject to special rules because breaking out savings and investment earnings from the provision of services is often difficult in practice.

Take the example of a bank loan. Banks incur labor and other costs in originating and servicing loans and working out bad debt. Some of these costs can be recovered through separately stated charges – for instance, a loan servicing fee. However, banks operating under a consumption tax would have the incentive to recover these costs as a component of the interest rate charged on the loan. Because the cost would be “hidden” in the interest rate—and thus the investment income earned on the loan—the bank would not have to charge tax on its loan servicing and administration services.

Another example is a savings account. As with servicing loans, banks incur labor and other costs in administering a customer’s account. Banks operating under a consumption tax could recover these costs simply by allowing the customer’s account to earn a lower interest rate.

The same could be said for “free” services that the bank provides. For instance, the cost of issuing “free” paper checks to accountholders can be recovered by lowering the interest rate that the account earns. Because the cost of the “free” paper checks is not charged to the customer, but is instead hidden in the lower interest rate, banks would not have to charge tax on the provision of the paper checks to the customer.

Below is further information on how the PCTA treats financial products and services, along with specific open issues.

## **General Treatment of Financial Products and Services**

The PCTA defines a very narrow category of “financial supplies” that are exempt from PCT. These categories are based on experiences with the implementation of modern goods and services taxes, such as those in Australia and New Zealand. All other financial-related products and services that do not fall into these categories are subject to the PCT. For instance, if a bank offers an account holder paper checks, the bank must charge PCT on the cost of those checks to the account holder.

### **What still needs to be done?**

The application of consumption taxes to the financial services sector is difficult. While the structure in the PCTA as introduced will remain the same, feedback from stakeholders is needed to ensure that complicated financial transactions are taxed appropriately.

The introduced version of the PCTA completely exempts a narrow class of financial products and services. However, additional clarifications will likely be added to this general rule.

In particular, rules similar to those in other GST systems like Australia will be considered. These rules include providing reduced input tax credits for certain inputs related to financial supplies. Rules for businesses that supply an ancillary amount of exempt financial products and services compared to their total business activity will be examined in the next version as well.

While other countries have experiences with these issues that are very helpful to draw from, we anticipate that the U.S. financial services industry will have unique challenges that will need to be considered and addressed.

### **How do I submit a comment on the PCTA’s application to financial products and services?**

Comments on all aspects of the PCTA, including the financial products and services section, are welcome. The PCTA was introduced the 113<sup>th</sup> Congress to provide an opening for discussion and a first opportunity to review legislative language for this type of comprehensive tax reform. The goal is to introduce an updated PCTA next Congress after considering stakeholder input.

If you have a suggestion on the *Progressive Consumption Tax Act*, or more questions, please email [PCT@cardin.senate.gov](mailto:PCT@cardin.senate.gov). After a period of considering comments from stakeholders and analyzing its revenue impacts, the *Progressive Consumption Tax Act* will be reintroduced in the 114<sup>th</sup> Congress.